PANIC PREVENTIONS AND CURES

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The United States has periodically been afflicted with financial cataclysms, popularly called "panics." They have marked turning points in trade and development, where prosperity and "good times" have given place to liquidations and "hard times."

Other countries have not experienced these almost regular revulsions, and from this fact it may be inferred that they are unnecessary here. Wild and speculative business enterprises and dishonest or reckless banking and trading cannot be entirely prevented or guarded against, but their effects ought to be confined to the interests directly concerned, and not permitted to affect entirely distinct and different affairs. And, on the other hand, the peculiar character of our business operations—their great and varying magnitude, moving forward at one time with astonishing rapidity and then subsiding with equal suddenness—clearly shows that the conditions here are very different from the staid and orderly movements in the business of the old world.

Panics or trade revulsions, therefore, may be unavoidable with us at some periods, or at some stage of business progress. Those which have occurred in the past can be clearly explained by natural causes, and it therefore may be believed that no panic of the character described can occur unless there is some natural cause or explanation for it.

In the present disturbance there does not seem to be a single natural cause to account for its occurrence. We have had no crop failures—that prolific cause for financial depression. On the contrary, our crops of all kinds have been unusually good and the prices of farm products taken together have never been better. The reduction of farm mortgages in the West and the growth of bank deposits in rural communities indicate remarkable strength in material wealth.

Our mines for both the precious metals and the crude products have been operated to their fullest capacity with the largest pro-

duction ever known, our factories and mills have been unable to fill their orders, and business of all kinds has been expanded apparently upon safe and conservative lines to an extent never before known. Immigration of laborers from Europe has been enormous, exceeding any period in our history, and yet all classes of labor have been fully employed at good wages. This situation is in strong contrast to 1892 or thereabouts, when Coxey's army of the unemployed marched on Washington. Judging from these and many other facts, it may well be doubted if this is a panic similar to those which have formed such memorable epochs in our national history.

It may prove to be more of the character of the spasms which occurred in 1884 and 1890 and which have never been dignified with the name of panics. Those who believe in the mysterious theory of cycles must take notice of the fact that from 1857 to 1873 is sixteen years—while from 1873 to 1893 is twenty years, indicating what would be expected, a lengthening and not a shortening of the periods; counted in this way, the real crisis is not due. But whether this is so or not, the situation is sufficiently serious to call for the closest consideration. It proceeds apparently from impulses in trade and commerce of annual recurrence, which only need some special exciting cause to make them full of the gravest possibilities.

If the trouble is due to some weakness in our banking establishment—if it is something that legislation can remedy—then surely the needed legislation can be obtained. But until those credited as experts in finance can agree among themselves upon some plain and definite corrective procedure, instead of advancing all kinds of revolutionary schemes—using the situation as a club to advance them—it should not be a matter of surprise that public sentiment cannot be roused in favor of the so-called reforms, and legislators will be slow to adopt any of the schemes proposed.

Causes of Disturbance

The present disturbance has originated in New York. This is no reflection upon New York. That city is the heart of our financial system. We must look to it for all that is good in it, and it would be singular if anything bad should not also be evolved and developed there.

We must go back at least as far as April, 1903, when the great stock panic occurred, to discover the determining cause of the present situation. The extent of the drop in prices at that time and immediately following is indicated in the quotations of three first-class railroad stocks, which are selected as ones that would be the least affected by any depression:

	1902.	April, 1903.	Subsequently in 1903.
New York Central	168⅞	128½	112⅝
Pennsylvania	170	132½	110½
Chicago and Northwestern	271	174	153

The average loss indicated by the above figures which must be less than the average of all the stocks dealt in, if applied to the aggregate of all stock listed, would reach a sum that would dazzle the mind. It was a real shrinkage in apparent wealth, although the fall occurred without regard to net earnings and dividends which underwent no decrease. During the following years there was more or less recovery, but nevertheless the New York money market was seriously affected by the great capital loss shown in the depreciation of stocks and has been in a sensitive condition ever since. The same stocks have now fallen as low as 91½, 103½ and 126 respectively.

The reasons advanced for the tremendous fall in stocks and bonds have been various. Many influences may of course have had their bearings, but there is one fact which is undeniable, and is sufficient of itself to account for it. This has relation to the capital supply.

The productive resources of this country have been so enormous that capital sufficient to carry through almost any enterprise or undertaking, no matter how many millions or even hundreds of millions were involved, seemed at hand for the asking. It is a matter of wonder and bewilderment to the ordinary thinker where all the capital has come from to swing the enormous undertakings, which have been planned and carried through to successful termination during the last decade.

Notwithstanding these vast expenditures of the past, still vaster ones are planned for the future. A French financial writer has recently called attention to these tremendous proposed outlays of capital. He estimates the annual requirements of the United

States alone as $2,500,000,000.00, while our national income he says does not amount to one-third of that sum. He also shows that these extraordinary demands to be made upon capital are not confined to the United States, but extend in growing volume all over the world. Within the past decade the losses or wastes of capital have also been enormous. In this country we have had the Spanish War and San Francisco fire, while Europe has had to finance the Boer and Russo-Japanese Wars—the latter estimated alone at three billions of dollars.

The question of capital is, therefore, of world-wide application. There must be a limit to the available supply, but the strain upon the supply can only be developed in the course of events and cannot be easily anticipated. It will of course be shown in the rise of the interest rate. When new securities are placed upon the market upon more advantageous terms for the lenders than previous offerings, the price of the latter will naturally fall, and continued drains upon the capital supply must have the same effect in raising the interest rate that the ordinary law of supply and demand under similar conditions has upon the price of commodities. There is quite a difference in the value of a long-time security figured upon, say, a 3½ per cent basis and at 5 per cent or more. It is therefore quite clear that the depreciation in stocks and bonds caused enormous losses to their holders, and the effects of such losses would also be evidenced in the money dealings. The direct effect it had upon the banking business in New York is shown in the loss in bank deposits. The statements of the national banks for August 22d this year, compared with same period in 1906, showed a loss for the New York City national banks, in individual deposits alone, of $126,000,000.00, while the banks in the country outside of New York had gained $245,000,000.00.

The Panic

The exposures of the methods pursued in the Heintze and Morse banks, the troubles of the Mercantile and connected national banks, and runs on the trust companies, culminating in the closing of the Knickerbocker Trust Company, were sufficient to cause the excitement which followed and rendered imperative the suspension of currency payments by the New York banks. But this action undoubtedly led to withdrawal of capital from active use in another

manner to a far greater extent than was indicated by the bank runs. The suspension in New York, followed by similar action in all of the reserve centers, was a severe shock to bankers everywhere. The dread specter of bank runs possessed their minds, and a craze to accumulate currency became a feature with nearly every bank in the country. This action on the part of the country banks was entirely natural and cannot be properly criticized. It is the almost inevitable result of an erroneous banking system. When New York is afflicted with a greatly depleted capital supply and currency is demanded to satisfy depositors, relief in time will be obtained from London and other parts of the world and from the United States Treasury, if it has any funds that can be deposited. But the interior banks are in an entirely different position. Having nothing to expect in the way of aid if needed from New York or other clearing-house centers, they must rely solely upon themselves. Self-preservation is the first law of nature, and they must accumulate all the currency possible in the expectation of a contingency which may never materialize, but the fear of which is as real in its effects as if it were an actuality.

The reserves not only of the country banks, but of all banks, with few exceptions, everywhere, will be shown by the reports of December 3d to be increased anywhere from 25 per cent to 50 per cent over what they were on August 22d, and they were excessive at that date. A contraction of active capital to this extent within so limited a time must be of ominous portent to the business of the country.

Temporary Cure

An emergency circulation of the character of that recommended by President Roosevelt would without doubt be effective as a temporary measure. The problem involved is a simple one. In some manner the capital withdrawn by frightened banks and bank depositors should be returned to circulation. The difficulty is that it will come too late to serve the present disturbance. It will take too long a time to enact the law and prepare the notes to be circulated. The lesson, however, ought not to be lost even if the measure should not become effective until a like disturbance occurs in the future. It can plainly be seen that if an emergency circulation had been at hand for immediate use, the present crisis

would have been controlled at its inception, to the great gain of the country at large, and at no expense or risk to the public. On the contrary the public revenue would have been increased from the tax collected.

There should not be any disagreement as to the particular method to be adopted. The object of the emergency issue is to relieve the business situation, and it is especially intended for those banks carrying the loans of manufacturers and dealers, so that these may not suffer too severely from the sudden contraction of loanable funds.

If it is based solely upon approved municipal or corporation securities, it will be of special benefit to the owners of such securities, and of only indirect benefit to the interests to be served. Clearing-house loan certificates, secured by a pledge of actual commercial securities guaranteed by strong banks, would seem to be the most acceptable security for the purpose. The aid would then be given exactly where it is needed, and the certainty of the retirement of the notes within a reasonable time would also be secured. Emergency circulation, however, is only an expedient to relieve a condition which ought to be of almost impossible occurrence.

Asset Currency

The peculiar weakness of our banking system has long been recognized and commented upon, but the plans suggested for its reform have almost uniformly favored the issue of uncovered bank notes, generally called "asset currency." The weakness referred to has been almost annually demonstrated—first a period of redundancy then one of stringency, frequently accompanied by panicky conditions. These varying circumstances are explained by many as due to defects in our currency system. It is asserted that our money is not elastic as it should be; that it does not expand and contract with the demands of trade, and that in these respects our currency is different from that used by other great commercial countries, and hence the difference between the operations of their money market and ours. To cure these defects, it is insisted that authority should be given the national banks to utilize their credit, or, as has been said, to "coin their credits," by the issue of a

certain amount of bank notes without the security of government bonds, or, in fact, without any pledged security. Judged by the amount of brains exercised, and energy, as well as money, expended during the past ten years in the furtherance of these views, it would seem that some decided, favorable impression would have been made upon the public mind. Doubtless many views have been molded by what appears to be the unanimous conclusion of financiers and money experts who have given the subject special consideration. The American people, however, will go slow in accepting these conclusions. The money question is not the peculiar cult of a class, but, thanks to the education of the political campaigns in recent years, it is one open to all classes, and especially business men, who will instinctively refuse support to measures which involve change—and perhaps radical change—in the foundation of all business enterprises.

The arguments offered in favor of the scheme are also not sound or convincing, and some misconceptions conveyed concerning other currency systems can be easily corrected.

The quantity and character of our money supply on November 1, 1907, were as follows:

Gold coin and bullion	$1,561,714,719
Silver dollars	568,249,982
Subsidiary silver	136,201,145
U. S. notes	346,681,016
National bank notes	656,218,196
	$3,269,065,058

Population 86,666,000, per capita	$37.72
Compared with other countries:	
Great Britain, per capita	18.02
France, per capita	39.94
Germany, per capita	22.13

The total volume of money in Great Britain is $787,600,000, which is only about one-fourth of ours, and yet with this supply she manages not only her own finances, but those of a great part of the world.

The per capita comparison is still more startling for that portion of our circulation dependent upon gold for its parity therewith:

U. S. notes and national bank notes	$1,002,899,212
Deduct gold reserve	150,000,000
Total uncovered	$852,899,212

United States, per capita	$9.84
Great Britain, per capita	2.67
France, per capita	3.02
Germany, per capita	3.53

If we add to our uncovered currency, silver certificates $464,-349,568, which are also dependent upon gold, the per capita is increased to $15.20.

These comparisons show that we have the largest volume of money of any country in the world, and that, with the exception of France, which we nearly equal, we have the largest per capita. Our uncovered paper has a per capita more than three times that of any other country, not excepting France. This apparent over-abundance of money is admitted by those who urge the asset currency scheme. One of the members of the American Bankers' Association has this to say:

"Commerce really suffers more in the long run from periods of over-abundance of our present circulation than from those of scarcity. The origin of each recurring period of tight money can be traced to preceding periods of easy money. When the maximum demand for currency occurs, so much of it is required that the banks with difficulty maintain their legal reserves, but when the demand is at its minimum, the currency accumulates in their vaults and they resort to forced loans, inflated credits, cheap rates and other artificial methods to keep it employed and earning something."

If it is as this writer states, the excessive quantity of our existing currency which causes the over-abundance of loanable funds at certain periods, in what manner can that situation be improved by an addition to that quantity?

Will not the additional circulation tend to intensify the evils complained of?

The over-abundance, however, referred to is not necessarily "currency," although this writer conveys that idea. In actual effect it is an increase in cash resources by means of increased deposits or by the payment of loans. If during this period, in order to keep

the excess funds "employed and earning something," the banks make "forced loans" and extend "inflated credits," it can easily be seen that when the "tight money" period comes they are in no condition to make the legitimate loans which the business interests of the community demand. To authorize the issue by the banks of a credit currency under such conditions would be an economic error and one that in the end would cause greater disasters than those its issue was intended to prevent.

That it is not merely an excess or redundancy of currency which causes the shifting periods can easily be seen by examining statistics. The actual volume of cash held by the New York banks does not vary greatly in the course of a year, and yet during the same time large excesses or deficits in reserves will be shown in the weekly reports. Comparison between the last summer statement and the first fall one in the reports to the Comptroller for a number of years past will show that the volume of cash held has oftener been larger in the fall than in the summer, and disproves the idea that it is solely a currency drain which marks the activity of that period.

It is asserted that the proposed notes would not be a permanent addition to the circulation—that having performed the service for which they are intended, by some means not clearly shown, they will be returned to the issuing banks and canceled. In the American Bankers' Plan a tax of 2½ per cent per annum is imposed upon the first issue—this however would not be sufficient to cause the return of the notes in even the easiest money period. It is possible that some eastern banks would then retire them, but the proposed issue is for banks all over the country and in sections where such a low interest rate is unknown.

Hon. Charles N. Fowler, the persistent advocate in Congress of asset currency, in his plan wants no tax. In a recent speech he says:

"Our bank notes must spring into existence precisely as checks and drafts do, through business transactions. Our bank notes should be related to and based upon the consumable commodities of the country, going out with production and coming in with consumption." These are brave words but highly figurative. It will be easy enough to spring them into existence with or without production, but what is there to bring them back with consumption?

Where hangs the string to this kite that will anchor it safely and bring it to land when desirable? The American people of this generation are not accustomed to any but the best kind of paper money. It has passed readily from hand to hand with unquestioned credit, and has continued to circulate until worn out. The only thing besides a tax that will force redemption is doubt as to the continued goodness of the notes.

If the money Mr. Fowler has in his mind is similar to "checks and drafts"—such money, for instance, as the banks throughout the country have recently been forced to put out, much to their own disgust as well as that of their customers, then we may be able to understand what he means. It will come back, all right, provided it ever gets out, but the country wants no such money as a constant diet.

The assertions made concerning the use of similar currency in other countries have very slight foundation to support them. For instance, Mr. Fowler in this recent speech declared that "no civilized country now has a bond-secured currency such as we have, and no country ever did have such a currency." This statement is made in face of the fact that the Bank of England's "fixed" issues are against government securities, and aside from these issues, that great bank does not put out a single pound that is not against a similar amount of gold coin or bullion.

Much also is said concerning the elasticity of the Scotch bank-note system. In a recent paper by Mr. George M. Coffin, this elasticity is sought to be shown by figures. He states very correctly that no paper currency "uncovered by coin" can be issued by the banks of Great Britain, except their "fixed issues," determined by Act of Parliament and limited to the circulation existing at the time of the English Bank Act of 1844, extended to Scotland in 1845. These "fixed issues" of the Scotch banks he gives as £2,676,350 ($13,000,000). The elasticity of British currency he says "is confined within the limits of the 'fixed' issues of uncovered currency."

He then gives a table of circulation for a number of months in 1905-06, the maximum during the period for the Scotch banks being £8,091,692 and the minimum £6,906,103, the difference being the extent of the elasticity claimed. As the fixed issues only aggregate £2,676,350, the figures in the table are all at least three times

the sum of the fixed issues, and if they show anything it is that the entire fixed issues are constantly out, with neither accession nor diminution to their quantity, and therefore are about as inflexible as any money could be. The remainder of the note issues are covered by coin. In this country we would not be willing to accept, as an example to be followed, the currency system of Scotland, in which the note circulation can only be increased as the gold reserve is increased, and must be decreased as the gold reserve goes down.

Viewed from every standpoint, the proposed issue of credit bank notes should be deprecated. Their use is not sustained by the practice of the most enlightened financial power, nor is it demanded to correct any defect in quality or lack in quantity of our existing currency. That currency possesses in a high degree the elasticity which gold possesses in a larger field, moving as the representative of capital from one part of the country to the other, just where it may be most needed. Its free movement however is trammeled by law, whereas legislation has always failed to hinder the international movement of gold. This leads to the consideration of the real weakness in our banking system.

Inelastic Bank Reserves

The weakness lies in the immobility of our bank reserves. In Great Britain no reserve is required by law to protect bank depositors, but with us both under federal and state statutes a fixed reserve of a stated ratio upon deposits is demanded. Dealing as they must with such a multitude of banks our law-makers have adopted this expedient as the best protection at hand.

Mr. W. R. Lawson, an English financial writer, in an article published some years ago in the "London Bankers' Magazine" (republished in the "New York Bankers' Magazine," February, 1903), comments upon this feature of our banking system as follows:

"We wish to point out that a very large portion of United States currency is a legislative fund only, and but for certain laws might be dispensed with. The *raison d'etre* of such law-made money is to guarantee bank deposits, in other words to insure safe banking. Thus a large part of the currency exists not for purely monetary but for banking reasons. It is the workman and not the tools that are at fault. As a purely monetary proposition there is

no proof whatever that the United States has an insufficient currency. The official statistics indicate that even eighty millions of people have no real use for $2,336,000,000 of circulating medium. Moreover 'elastic' banking is required then, rather than 'elastic' currency." What this intelligent and observing foreigner says concerning our money system will be admitted by every thoughtful investigator.

It is this struggle between banks to maintain reserves that almost annually brings the country to the verge of a panic.

The following figures will show the amount of cash reserve required by law as shown in the national bank reports for August 22, 1907, and the cash actually held at that date:

	Required.	Held.
Central reserve banks	$301,371,801	$321,361,557
Other reserve banks	177,929,155	205,397,797
Country banks	157,629,879	238,141,834
	$636,930,835	$764,901,188

In the above statement the central reserve banks held 6.6 per cent of legal reserve more than required, the other reserve banks 15.4 per cent, and the country banks 51.3 per cent—all of which is very suggestive considering what occurred only a few weeks afterwards. This is the showing for 6,544 banks out of a total of nearly 18,000 of all kinds. We are not prepared to agree with Mr. Lawson as to the uselessness of these reserves. It is true that an equal amount of protection would be given if a large portion of them was composed of good interest-bearing securities instead of money. The money reserve however serves a double purpose—it is both security and money, and therefore the very best kind of reserve under the conditions imposed by our multitudinous banking system. No one would recommend the lessening of this required reserve of cash on hand; on the contrary there is a tendency to increase it.

The reform plainly needed is some plan by which these reserves may be utilized without impairing or endangering their value as security for deposits.

In this connection a government bank is suggested and perhaps is received with more favor than any other scheme proposed. There is much to commend in the idea, provided its scope could

be confined to transactions between banks. This limitation would probably render the scheme impracticable, and an organization of the kind for the prosecution of a general banking business would be as little favored by bankers as it would be by the public generally.

So many plans have been offered as certain cures for our financial ills that the writer hesitates to add to their number. But if his diagnosis of the trouble is correct, if it is admitted that a large volume of currency is constantly hoarded as bank reserves, which, in times needed, should be utilized as working capital to aid the legitimate business enterprises of the country, then it would seem that the problem is a simple one.

In the opinion of the writer the difficulty may be largely if not entirely solved in an effective manner along the lines of what we already have in practice.

Measures Suggested

First.—The cash actually required on hand in banks should be simplified and made to embrace the various kinds of our money held under the general term "cash." A detailed statement is now required in reports showing the different kinds of money on hand, and all of it is counted as reserve except national bank notes, nickles and pennies. There is no just ground for this exclusion of national bank notes. Our money is all of equal quality. The bond-secured notes have more security back of them than the legal-tender notes. They are public obligations and not ordinary bank notes, for the government guarantees their payment, and is secured in so doing dollar for dollar by its own bonds, and in addition thereto a reserve of legal-tender money deposited with the Treasurer of the United States. These notes have performed a valuable public service in the support of the government credit. By their means the financial credit of the United States has been made higher than that of any other nation in the world, its long-time 2 per cent bonds selling in the market at from $1.05 to $1.10, while 2½ per cent British consols bring little more than eighty cents.

The public recognizes no distinction between legal-tender money and other kinds which are not legal tender, such as gold and silver certificates, as well as national bank notes. All have equal credit and pass readily from hand to hand.

In fact dense ignorance prevails among all classes of people

as to what is legal tender and what is not. An amusing illustration of this fact occurred in an editorial a few weeks ago in one of the most popular New York banking journals. Under the heading "Legal Tender" the article said: "Indifference and ignorance on the subject of legal tender is widespread and colossal. Among the few wise things along currency lines which have been done in this country is the adoption of the English system of composite legal tender. Gold is our only legal tender in unlimited amounts. Greenbacks and silver are legal tender up to a certain fixed sum, beyond which the acceptance of them cannot be compelled."

Of course the editor had not perused recently what is printed on the back of every greenback and had forgotten all about the "dollar of our daddies." It is not necessary that the bank notes should be made legal tender, but in view of the fact that fixed reserves are intended mainly for the protection of depositors, will anyone maintain that this protection is weakened if national bank notes are so counted?

Second.—The banks should be encouraged to keep a portion of the fixed cash reserve with the Treasurer of the United States. This would be accomplished if the balances maintained with the Treasurer were allowed to be counted as cash on hand. In Great Britain the banks in making reports include in their cash on hand money on deposit in the Bank of England.

Third.—The existing practice of the Secretary of the Treasury in lending public funds to the banks upon approved securities should be further extended, so far at least as this bank fund is concerned. Instead, however, of depositing with specially selected banks, it should be arranged in the form of direct advances to all banks supplying satisfactory securities. In order to effect this, open accounts should be maintained with all the banks, and they should be permitted at all times to draw on the Treasurer, first, to the extent of their credit balances, and, second, to the extent of the treasury value of the approved securities held by him.

In order to more formally pass on these securities a board of treasury officials may be created, composed of say the Secretary of Treasury, Secretary of Commerce, and Comptroller of Currency. To this board should be given the power to fix, from time to time, the interest rate which should be charged on all daily debit

accounts, the interest collected in this way to be distributed to the credit accounts somewhat in the same manner as interest distribution is now made in clearing-house associations upon loan certificates. The expenses should also be provided for by a just and equitable tax upon the banks.

This plan would of course require more clerical force than the department now accords to this business, but as both deposits and checks would be in round sums, much of the complication of a regular banking business would be avoided.

As the interest rate advanced, the greater would be the inducement to increase deposits with the Treasurer, and this advance and fall of the interest rate would supply in a steady and comprehensive manner a financial barometer of monetary conditions, which is now absolutely lacking. It now requires but comparatively a small drain upon the New York bank reserves to cause all kinds of perturbations in the money market.

Estimating that one-half of the present fixed cash reserves of the national banks should be deposited with the Treasurer, this would alone provide a fund of over $300,000,000. No interference would necessarily occur with that portion of the reserves which may be maintained with national bank reserve agents. With this plan in successful operation, it may easily be conceived that the instability now afflicting our money system would in a large measure be corrected, that the annually recurring periods indicating incipient panics would be prevented, and the danger avoided of absolutely uncalled for financial revulsions, with their attending commercial and industrial losses and suffering.